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021709Z Dec 05

C O N F I D E N T I A L SECTION 01 OF 03 OTTAWA 003572

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USDOC/ITA/IA: J TERPSTRA

E.O. 12958: DECL: 12/02/2015

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SUBJECT: CANADA'S FOREST INITIATIVE: LESS THAN MEETS THE EYE

Classified By: Econ Minister Counselor Brian Mohler, Reasons 1.5 (b) and (d)

11. (SBU) Summary: While it does raise subsidy concerns, there appears to be much less than meets the eye in the GOC's November 24 announcement of a new CAD 1.5 billion (USD 1.27 billion) forestry package. In particular, the CAD 800 million figure for loan insurance appears to be a political mirage. Some industry experts have welcomed the package, but others have dismissed it as pre-election fluff. The government could begin disbursing some elements of the aid package immediately, but the eventual total is likely to be much less than CAD 1.5 billion and the bulk of the aid may go to troubled pulp and paper operations. Given the transparently political nature of the announcement, it may not merit much further USG response, at least until the election is over. End Summary.

12. (SBU) On November 24, the Canadian government announced its &Forest Industry Competitiveness Strategy8, describing it as an &initiative worth almost CAD 1 billion to ensure the continued competitiveness of the Canadian forest industry in the global marketplace.8 (Note: all figures are in Canadian dollars; 1 CAD = approx .85 USD) The initiative, timed to play to maximum advantage as the country moves toward January elections, offers a variety of assistance, much of it geared toward local communities. Context is everything; this initiative is just one part of a flurry of pre-election largesse from the outgoing Liberal government for everything from new tunnels for the Department of National Defense to theme parks on Prince Edward Island. Much of this new funding, unsurprisingly, is aimed at Quebec, where the Liberal Party is in danger of losing seats to the Bloc Quebecois.

13. (SBU) A closer examination of the forest program, however, suggests that both total and annual outlays are likely to be a fraction of the ballyhooed \$1.5 billion. Following is our preliminary analysis of the scope and impact of these programs, in order of scale. Econ staff are seeking a meeting with Industry Canada officials in the next few days to answer some of the questions raised by the text of the announcement.

Loan insurance) \$800 million (but not really)

14. (SBU) The biggest part of the package is funding set aside to insure (via commercial insurance, not government guarantees) bank loans to &firms affected by the unique circumstances of the softwood lumber dispute.8 The funding &will help facilitate up to \$800 million in loans.8 Based on this description, it appears likely, notwithstanding public statements by the Liberal leadership, that the actual government outlay is likely to be a small fraction of the loan total. Industry reaction has been mixed. One Quebec industry expert called it &nonsense8 and industry contacts in British Columbia described it as &pre-election gimmickry8 and predicted that BC firms would not be likely to participate. As most U.S. countervailing duty deposits for softwood lumber come from BC firms, their nonparticipation further reduces likely spending under this program. Quebec industry officials complained that only \$150 million (presumably in new loans) would be available to Quebec's troubled forestry firms, which have been hit harder by market conditions in pulp and paper and the rise in the loonie than by U.S. deposit rates. (Embassy Comment: In fact the program appears tailor-made for the Tembec Corporation, which has been trying to shop its deposits to banks as &accounts receivable8, without success so far. Predictably, Tembec CEO Frank Dottori welcomed the move. End Comment.) We understand that because this program is covered by an existing framework program under the Industry Canada Act, the government can make these payments for loan insurance without further legislative or administrative review.

Advanced Forest Technologies Program

15. (SBU) The next largest item in the program is the

Advanced Forest Technologies Initiative (AFTI), which will receive \$215 million in additional funding over five years. According to the official press release, it will &increase the competitiveness of the Canadian forest industry by providing the momentum and financial incentives required for commercial-scale development and application of transformative technologies (allowing) the Canadian forest industry, especially pulp and paper industry, to enhance its competitive position, improve its environmental performance and take advantage of the growing bio-economy⁸. While this description seems to imply a financial benefit, it also suggests that funding will not go primarily to the big softwood producers. Post is seeking further detail on AFTI from Industry Canada.

National Forest Community Adjustment Fund

¶6. (U) \$150 million over five years will go to regional development agencies and the Federal Economic Development Initiative for Northern Ontario for community support and economic diversification in &communities affected by recent job losses in the forest industry⁸. At first glance, this appears to be an extension of existing community adjustment programs. (Prime Minister Martin referred to this program in a campaign stop yesterday in Cornwall, Ontario, where Domtar Corp. is shutting down a pulp and paper plant with a loss of over 900 jobs.)

Industry Support Program

¶7. (U) \$100 million will be made available to regional development agencies in &support to firms to address short-term viability pressures⁸ via &conditionally repayable contributions⁸ to firms affected by the softwood lumber dispute but not eligible for the loan insurance program (presumably struggling smaller firms that do not export). We are seeking clarification from GOC officials as to whether the stated value of the program is an annual or five-year total. It appears to raise some subsidy concerns; notably, the Atlantic provinces have declined to participate.

Support for Bioenergy

¶8. (U) An additional \$50 million over five years will be made available under an existing program, the Renewable Power Production Incentive, which is designed to encourage cogeneration. However, according to Natural Resources Canada, this program is not industry-specific and the new allocations will not be earmarked for the forest industry. NRCan is working to broaden the criteria for the incentive, mostly used by manufacturers and utilities until now, to make it more attractive to forest product companies and local municipalities.

Forest Innovation and Value-Added Wood Products

¶9. (U) The package includes \$90 million for various programs under this item over five years, and will &focus on precompetitive research.⁸

Growing Wood Markets

¶10. (U) The government intends to pump an additional \$66.3 million over five years into the existing Canada Wood Export Program (focusing on strengthening exports to China and other developing markets) and other existing export development mechanisms.

And Don't Forget the Workers

¶11. (U) Finally, Human Resource and Skills Development Canada, roughly the equivalent of the Department of Labor, will chip in \$10 million over five years to upgrade worker skills and recruit youth and underrepresented groups into the sector.

Doing the Arithmetic

¶12. (C) Comment: Based on the figures above, apart from the loan insurance program average annual spending under this initiative will probably amount to no more than \$122 million, a substantial sum but a far cry from the \$1.5 billion trumpeted by the Liberal government as it takes to the campaign trail. In addition, much may go to pulp and paper producers, whose problems have little to do with the softwood lumber dispute, or into the forests of northern Ontario. Moreover, government contacts have told us that some of the package is still "somewhat notional⁸; while it does not require legislative action, details remain to be worked out. While we are still looking for more detail, our view is that

the impact of this package on U.S. softwood producers is likely to be marginal at most, and does not merit further immediate USG reaction.

13. (C) In our view, the program probably serves two purposes: a) to ensure that Quebec's hard-pressed forestry companies get their share of the pre-election handouts, and (b) to create an additional bargaining chip should the GOC eventually return to the table. The Canadian media reports that some officials have already said they might review the package, although they have again described the quid pro quo (predictably) as the full return of all existing deposits. Once the campaign rhetoric subsides, there may be more of an opportunity for constructive dialogue on Canadian aid to its forest industry. End Comment.

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